

**Annual Report**  
**For the Fiscal Year Ended**  
**June 30, 2015**

***Electronic Control Security Inc.***

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790 Bloomfield Avenue, Bldg. C-1, Clifton, NJ 07012 Tel: (973) 574-8555 Fax: (973) 574-8562  
E-mail: [ecsi@ecsiinternational.com](mailto:ecsi@ecsiinternational.com) • Website: <http://www.ecsiinternational.com>

I.R.S. Employer Identification No.  
22-2138196

CUSIP No.  
285617106

**ISSUER'S EQUITY SECURITIES**  
**COMMON STOCK**

**\$0.001 Par Value**

**30,000,000 Common Shares Authorized**  
**16,366,618 Shares Issued and Outstanding**  
**as of the Filing of this Annual Report**

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**OTC Pink Basic Disclosure Guidelines**

**1) Name of the issuer and its predecessors (if any)**

The name of the issuer is Electronic Control Security Inc.

**2) Address of the issuer's principal executive offices**

Company Headquarters

Electronic Control Security Inc  
790 Bloomfield Avenue, Bldg C-1  
Clifton, NJ 07012  
Phone: 973-574-8555

IR Contact

Electronic Control Security Inc  
Daryl Holcomb  
790 Bloomfield Avenue, Bldg C-1  
Clifton, NJ 07012  
Phone: 973-574-8555  
Email: [d\\_holcomb@ecsiinternational.com](mailto:d_holcomb@ecsiinternational.com)

**3) Security Information**

Trading Symbol: EKCS.PK  
Exact title and class of securities outstanding: \$0.001 Par Value Common Stock  
CUSIP: 285617106  
Par or Stated Value: \$0.001  
Total shares authorized: 30,000,000 as of: September 15, 2015  
Total shares outstanding: 15,866,618 as of: September 15, 2015

Additional class of securities (if necessary): N/A

Transfer Agent

VStock Transfer, LLC  
18 Lafayette Place  
Woodmere, NY 11598  
Phone: 212-828-8436

Is the Transfer Agent registered under the Exchange Act?\* Yes:  No:

\*To be included in the OTC Pink Current Information tier, the transfer agent must be registered under the Exchange Act.

List any restrictions on the transfer of security:

None

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For the Period Ended June 30, 2015

Describe any trading suspension orders issued by the SEC in the past 12 months.

None

List any stock split, stock dividend, recapitalization, merger, acquisition, spin-off, or reorganization either currently anticipated or that occurred within the past 12 months:

None

#### 4) Issuance History

A. The nature of each offering (e.g., Securities Act Rule 504, intrastate, etc.);

**Under a Regulation D / Rule 506 offering, in January 2015, a director of the issuer was issued 500,000 shares of \$0.001 Par Value Common Stock at a price of \$.02 per share.**

B. Any jurisdictions where the offering was registered or qualified;

**None**

C. The number of shares offered;

Per  
**500,000**

D. The number of shares sold;

**500,000**

E. The price at which the shares were offered, and the amount actually paid to the issuer;

**Price offered and paid - \$.02 per share**

F. The trading status of the shares;

**Restricted**

G. and Whether the certificates or other documents that evidence the shares contain a legend (1) stating that the shares have not been registered under the Securities Act and (2) setting forth or referring to the restrictions on transferability and sale of the shares under the Securities Act.

**The shares issued contain a legend stating that the shares have not been registered under the Securities Act and setting forth or referring to the restrictions on transferability and sale of the share under the Securities Act.**

#### 5) Financial Statements

The financial statements for the fiscal year ended June 30, 2015 are incorporated by reference and can be found at the end of this Annual Report. The financial statements as of and for the fiscal year ended June 30, 2015 include: (1) Balance sheet, (2) Statement of operation, (3) Statement of comprehensive income (4) Statement of cash flows, (5) Statement of changes in shareholder's equity and (6) Financial notes.

# Electronic Control Security Inc.

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For the Period Ended June 30, 2015

### 6) Describe the Issuer's Business, Products and Services

A. Description of the issuers business operations:

#### Overview

Electronic Control Security Inc. ("ECSI" or the "Company" or "we" or "us") designs, manufactures and supplies stand-alone and fully integrated state-of-the-art entry control and perimeter intrusion detection systems for the Department of Defense, Department of Energy, nuclear power stations, and various international customers. We offer U.S. Air Force certified technology and a comprehensive services portfolio that includes: site survey/risk assessment, design & engineering, systems manufacturing and integration, factory acceptance testing, installation supervision, commissioning, operations and maintenance training. We work closely with architects, engineers, systems integrators, construction managers and owners in the development and design of security monitoring and control systems that will afford a normative but secure environment for management, staff and visitors. To support such efforts, ECSI's team of key personnel are technically accomplished and fully familiar with advances in planning, programming and designing systems utilizing standard peripheral components, mini/micro architecture, user friendly software/firmware selection and application.

#### Strategic Positioning / Competitive Advantage

ECSI's design experts are experienced in the various technologies (both mature and emerging) being applied to security challenges in the U.S. and world-wide because they have been intimately involved in developing "turnkey" security systems for U.S. Government facilities (Department of Defense (DoD), Department of Energy (DoE), Nuclear Regulatory Commission-licensed nuclear facilities, United Nations Conference Center in Addis Ababa, Ethiopia, and oil and gas facilities in Kingdom of Saudi Arabia and Algeria, as well as port security projects in Morocco and Nigeria.

We believe that our company is strategically positioned to leverage our experience and expertise because of the following:

- 39+ year track record with high customer retention rate;
- U.S. Air Force certified technology;
- Best industry warranty – 10 Years on select equipment;
- General Services Administration (GSA) contract, which is renewable year to year;
- Competitive Small Business (SB) capable of taking advantage of government solicited Small Business Set-Aside contract opportunities;
- Strong teaming arrangements with large systems integrators to supply technology and offer design and engineering support services to on multiple current and pending contracts;
- Award by Space and Naval Warfare Systems Command ("SPAWAR") on May 2, 2012 affords ECSI a five-year multi-million dollar contract vehicle for DoD project procurement; Separate award by SPAWAR on July 19, 2012, affords ECSI another five-year multi-million dollar contract vehicle for DoD project procurement; and
- World-wide implementation and support through robust domestic and international marketing and distribution network with multiple direct and indirect distribution channels and strategic partnerships for the Kingdom of Saudi Arabia, Iraq, Kazakhstan, Egypt, Kuwait, the Afghan/Pakistan border, and Zambia.

We believe that our competitive advantages include the following:

- providing the highest level of perimeter protection;
- offering supporting technologies and systems to enable total systems integration;
- delivering systems that are easy to operate and maintain while providing superior life cycle cost performance;
- solid credentials in protecting high value targets;
- best industry warranty

# **Electronic Control Security Inc.**

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For the Period Ended June 30, 2015

- superior technologies --- technologies targeted to the specific protected environment, and
- Interoperability Device Management System (IDMS) offering situational awareness and total system management.

B. Date and State (or Jurisdiction) of Incorporation:

**June 2, 1976; New Jersey**

C. the issuer's primary and secondary SIC Codes;

**Primary SIC Code: 3666**

**Secondary SIC Code: 3699**

D. the issuer's fiscal year end date;

**June 30**

E. principal products or services, and their markets;

### **Integration Support Services**

ECSI has worked with system integrators on various high-threat projects including the World Trade Center in New York City after the first bombing in 1993, Rocky Flats, Golden, CO., Pantex, Amarillo, TX, naval facilities in Washington, D.C. and Maryland, as well as UNECA's facility in Addis Ababa, Ethiopia. Each of these projects utilized different hardware and software platforms for the Central Alarm Station (CAS) and Secondary Alarm Station (SAS) including Livermore Argus System at the Pantex Facility.

It is imperative for a facility to have remote devices and subsystems integrated with the hardware and software at the CAS and SAS. The inherent design of an interoperable device management system (IDMS) lends itself to integrate with any of the remote devices and sub-systems that will be selected for a Perimeter Intrusion Detection and Assessment System (PIDAS). Based on our experience in system design, application, commissioning, training and operation, the integration of the various technologies proceeds in a seamless manner.

### **Consulting Support Services**

The consulting support services we provide our dealers/installers and system integrators are an integral part of the security solution. Effective and efficient use of technology can be achieved only if properly utilized. Toward that end, we assist our customers in conducting risk assessment and vulnerability/criticality studies to ascertain their security requirements and develop a comprehensive risk management and mitigation program; and provide security system design support services.

Our support services generally represent the first steps in assisting the dealer/installer or systems integrator to develop a security solution. The risk assessment, threat, vulnerability and criticality analyses that the system integrator utilizes allows us to develop effective responses necessary to address and mitigate the threat.

Our design personnel are expert in their knowledge of the various technologies (mature and emerging) and their application to security challenges, both in the United States and abroad, because they continue to be intimately involved in developing security systems for government facilities in the United States and overseas.

### **Security Industry Overview**

# **Electronic Control Security Inc.**

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The Security Institute of America estimates that the worldwide market for security products and services in 2016 will exceed \$8 billion. The industry encompasses a wide ranging, highly fragmented group of products and service providers which includes entities that market comprehensive security systems and offer security consulting services, such as dealers/installers, small single product companies, equipment manufacturers, and large systems integrators. We believe the security industry will continue to grow rapidly because:

- western nations have been the target of high profile terrorist attacks over the last several years that have squarely focused attention on security and threat issues;
- perimeter security for airports, maritime, chemical, transportation, energy and pharmaceutical facilities has been mandated by Homeland Security;
- newer, more effective and efficient security equipment incorporating advancements in security technology is replacing obsolete equipment;
- DoD & DoE are upgrading their facilities to enhance security while reducing manpower;
- nuclear power stations both in the United States and overseas have increased the level of security based on recent NRDC security requirements; and
- private industry is operating in more remote geographic locations and higher risk environments.

### **Product Design**

We design and develop new products based upon market requirements and as deemed necessary to meet clients' specific needs. We research and assess threat and vulnerability issues and design and engineer our products in-house, with outside consultants as needed, and in conjunction with joint venture partners to meet the requirements of clients based upon the results of such research. We investigate new and emerging technologies that have application in the security industry and seek to license these technologies which we may incorporate into our product line.

### **Products, Systems and Technologies**

The services and technologies required to create a secure environment must address the entire range of security concerns that challenge government and commercial institutions, including the protection of personnel and physical assets.

Our Integrated Security Solutions are comprised of one or more subsystems and components that perform a variety of security functions for a facility with a single Command and Control Center and, in certain cases, a back-up Command & Control Center that incorporates many of our systems integrated with legacy and Government or owner furnished technologies.

### **Product Focus**

**Automated Entry Control System (AECS)** automated vehicle/personnel gate system consisting of Radio Frequency Identification (RFID) to read vehicle tags, license plate cameras (front & rear), personnel card readers (e.g., proximity, barcode) and keypad, intercom and camera, anti-tailgating sensors, electric gates. Integrated system interfaced with facility's databases for rapid identification of vehicles/personnel for reasonable traffic flow.

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For the Period Ended June 30, 2015

**Infrared Perimeter Intrusion Detection (IPID®) U.S. Air Force Certified. Standard with Department of Energy and Nuclear Regulatory Commission power stations.** System offers an undefeatable barrier of pulsed infrared beams to create multiple intrusion detection zones, each with a range of up to 330 feet. Modular design can be stacked to form an invisible wall that cannot be penetrated without detection.

**Fiber Optic Intelligence Detection System FOIDS®** Standard with Department of Energy and several international oil & gas companies. Most advanced fiber optic sensor technology available for fence/wall line perimeter monitoring and intrusion detection. FOIDS® uses single mode fiber optic cable and highly sensitive interferometry technology for intrusion detection along fences and walls up to a zone length of 3.5 miles. The system detects climbing, cutting, and pulling along the fence/wall line. Technology does not use electronics in the field, has a range of over 60km, and uses single mode fiber optic cable.

**PTZ Cameras** The view of PTZ cameras can be adjusted a number of ways: Human manipulation, motion detection, door contact signals or automatically to a preset pattern. The use of PTZ cameras to automatically track an intruder based on an alarm from another technology provides the best solution.

**Day/Night & Thermal Imaging Cameras** Highest Rated, all weather environmental enclosures (-40°F to +149°F). High resolution sensor for clear, sharp imagery. Uniformity of picture (no white or dark borders found in other cameras). Smooth transition between extreme temperature differences. No "residue" trailing in picture when camera shifts positioning. Range up to 21Km (13 miles). Built-in video "trip-wire" intelligent motion detection. Full service support, including Maintenance and Repair

**ECSI Long Range Day / Night CCTV** ECSI's Long Range Day/Night camera offers imaging systems for any security application where lighting is impractical, too expensive or where long-range performance is required. For border security, port security, and critical infrastructure applications, the system has proven vital to threat detection initiatives.

**Vehicle Gate Automation** ECSI's smart gate consists of Radio Frequency Identification (RFID) equipment to read vehicle tags, personnel card readers (e.g., proximity cards, bar-coded information on identification cards and the Access Control Card (ACC), biometric validation, etc.), visual and acoustic devices supplying the Human-Machine Interface to alert the Security Force (SF) team to identification and threat assessment results, a computer-based access control system interfacing with the facility databases.

**ECSI Long Range Radar** Potential intruders entering oil fields, refineries, bases, or crossing borders can now be detected and monitored remotely using an innovative radar design. The radar systems, named "Area Intrusion Monitoring System" (AIMS) operate with uniquely low power and light weight solid state components.

**Water Infrastructure Sensing Equipment (WISE®)** Proprietary real-time, on-Line bio/chemical detection and reporting system. Continually monitors water flow for chemical and biological contaminants. Immediately reports out-of-parameter conditions (via e-mail or SCADA) to any number of recipients. Draws sample of contaminated water for further analysis. Offers capability of bypassing or shutting down flow of contaminated water. DoD/EPA tested.

### **Interoperable Device Management System (IDMS)**

Comprehensive interoperability platform for total system management capability. IDMS delivers comprehensive integration of security systems (transparent to the end user); single view of events and incidents (via customized role-specific graphical user interfaces and dashboards); process-driven event management (via graphical workflow tools, response plans and customized alarm stack design); analysis, status and management information (built-in report designers to provide timely and effective reports and statistics on compliance to security policies). Open

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architecture allows integration of new and legacy systems – ability to monitor and control systems simultaneously through one easy-to-use interface (automated entry control systems, intrusion detection systems, day/night & thermal imaging cameras, etc.) This technology permits the Command Control Communication and Computer (CCC&C) center to operate as the custodial and security nerve center where officers in the center have the ability to perform the IDMS monitoring and control process on one new network.

**Emergency Response Stations:**

The Emergency Response Stations provide the immediate response to potential security incursions. The surveillance system is monitored by sensor technology supplemented by CCTV cameras. The ERS is networked to the surveillance system and other sensor nodes through a redundant fiber optic network. The optical cameras provide immediate assessment of any potential target in the operational sector.

We believe that the technology we offer is qualitatively comparable to or more effective than those offered by our competitors because our products:

- provide low nuisance and false alarm rates;
- are reliable in virtually any environmental condition;
- in many cases can be user specified and adapted to their environment; and
- are subject to low installation and maintenance costs.

**Markets for Our Products**

We have identified a number of markets for our products and have developed programs to gain access to those target markets. The U.S. Government, along with many of its agencies and departments, represents a significant market for our products. We are now implementing a proactive marketing program to increase sales of our products to the following U.S. Government agencies, all of which have purchased our products in the past and will continue to be among our top customers. Further, in many instances, laws have been enacted and mandates decreed for compliance with some minimum-security standards. Airport security is a prime example. We target these entities as well as entities where we can demonstrate the need for security measures.

Primary markets that we target include:

- the U.S. Government, its agencies and departments, including the Department of Defense and the Department of Energy;
- border, airport and seaport facilities;
- energy facilities, including nuclear power stations, utilities, chemical-petrochemical pipelines;
- foreign/export opportunities in all of the above-noted target markets.

Our open-ended contract with the General Services Administration (GSA), which has been extended through July 31, 2014 and which is renewable year to year, authorizes the U.S. Government and a network of eligible sources to purchase materials and services from us on negotiated and approved prices without having to undergo a full competitive bid. The Company is a technology supplier to the three large system integrators selected for the FPS<sup>2</sup> program addressing United States Air Force Bases over the next four years.

Foreign/Export Opportunities. Government operations and private industries in foreign countries are all subject to the same security issues that challenge similar entities in the United States. We, along with our strategic teaming



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partners and international sales representatives, continue to seek penetration of these major market opportunities, i.e. Kingdom of Saudi Arabia, Kuwait, Qatar, Egypt, Uganda, Ethiopia, Ghana, Nigeria, and Zambia.

**7) Describe the Issuer's Facilities**

Our corporate headquarters are located at 790 Bloomfield Avenue, Clifton, New Jersey where we lease approximately 12,200 square feet of space divided among administrative (2,600 square feet) and manufacturing (9,600 square feet) space. We have renewed our lease for this space through April 30, 2018 at a rent of \$7,098 per month with an option to renew through April 30, 2028.

**8) Officers, Directors, and Control Persons**

A. Names of Officers, Directors, and Control Persons.

NAME	POSITIONS HELD
Arthur Barchenko	Chairman, CEO, President, Director, 22.9% owner
Natalie Barchenko	Secretary, 23.5% owner
Norman J Barta	Director
Daryl Holcomb	Chief Financial Officer, Director
Thomas Isdanavich	Vice President – Project Management
Stephen Rossetti	Director
Edward Snow	Director
Richard Stern	Vice President – Manufacturing and Sales Support
Ronald Thomas	President – SEM Consultants III, Inc., Director

B. Legal/Disciplinary History. Please identify whether any of the foregoing persons have, in the last five years, been the subject of:

1. A conviction in a criminal proceeding or named as a defendant in a pending criminal proceeding (excluding traffic violations and other minor offenses);

**None**

2. The entry of an order, judgment, or decree, not subsequently reversed, suspended or vacated, by a court of competent jurisdiction that permanently or temporarily enjoined, barred, suspended or otherwise limited such person's involvement in any type of business, securities, commodities, or banking activities;

**None**

3. A finding or judgment by a court of competent jurisdiction (in a civil action), the Securities and Exchange Commission, the Commodity Futures Trading Commission, or a state securities regulator of a violation of federal or state securities or commodities law, which finding or judgment has not been reversed, suspended, or vacated; or

**None**

4. The entry of an order by a self-regulatory organization that permanently or temporarily barred suspended or otherwise limited such person's involvement in any type of business or securities activities.

**None**

C. Beneficial Shareholders. Provide a list of the name, address and shareholdings or the percentage of shares owned by all persons beneficially owning more than ten percent (10%) of any class of the issuer's equity securities. If any

# Electronic Control Security Inc.

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of the beneficial shareholders are corporate shareholders, provide the name and address of the NAME (s) owning or controlling such corporate shareholders and the resident agents of the corporate shareholders.

NAME OF BENEFICIAL OWNER	PERCENT OF CLASS BENEFICIALLY OWNED
Arthur Barchenko (1)	22.9%
Natalie Barchenko (1)	23.5%

(1) Address of each person listed is c/o Electronic Control Security Inc., 790 Blomfield Ave., Bldg. C-1, Clifton, NJ 07012

### 9) Third Party Providers

Please provide the name, address, telephone number, and email address of each of the following outside providers that advise your company on matters relating to operations, business development and disclosure:

#### Legal Counsel

David Aboudi  
Pearl Cohen Zedek Latzer Baratz  
1500 Broadway, # 12  
New York, NY 10036  
Phone: 646-878-0800  
Email: DAboudi@PearlCohen.com

#### Accountant or Auditor

**None**

#### Investor Relations Consultant

**None**

#### Other Advisor:

**None**

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**10) Issuer Certification**

The issuer shall include certifications by the chief executive officer and chief financial officer of the issuer (or any other persons with different titles, but having the same responsibilities).

I, Arthur Barchenko certify that:

1. I have reviewed this annual disclosure statement of Electronic Control Security Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

September 28, 2015

/s/Arthur Barchenko

Arthur Barchenko  
CEO & President

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I, Daryl Holcomb certify that:

1. I have reviewed this annual disclosure statement of Electronic Control Security Inc.;
2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

September 28, 2015

/s/Daryl Holcomb

Daryl Holcomb  
Chief Financial Officer

ELECTRONIC CONTROL SECURITY, INC.  
AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2015 AND 2014

**Electronic Control Security Inc.**  
**Consolidated Financial Statements**  
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Electronic Control Security Inc.  
Consolidated Balance Sheets

	June 30, 2015	June 30, 2014
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 4,868	\$ -
Accounts receivable, net of allowance of \$451,000 and \$436,000	717,978	695,530
Inventories	1,503,965	1,636,028
Current portion of deferred income taxes	355,066	284,006
Other current assets	8,102	23,580
Total current assets	2,589,979	2,639,144
Property, equipment and software development costs - net	77,509	147,922
Intangible assets - net	647,462	723,197
Deferred income taxes	766,183	726,748
Other assets	8,321	11,876
	\$ 4,089,454	\$ 4,248,887
<b>LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)</b>		
Current Liabilities		
Accounts payable and accrued expenses	\$ 1,648,078	\$ 1,457,579
Due to officers, shareholders and affiliates	1,394,647	983,216
Subordinated liabilities to officers and shareholders	848,080	-
Current maturities of long-term debt and leases	409,319	443,540
Total current liabilities	4,300,124	2,884,335
Noncurrent liabilities		
Long-term debt and leases	2,870	6,848
Subordinated liabilities to officers and shareholders	-	848,080
Total liabilities	4,302,994	3,739,263
Shareholders' equity (deficit)		
Series A Convertible Preferred stock, cumulative, \$.01 par value; \$2.00 liquidation preference; 5,000,000 shares authorized, 300,000 and 300,000 shares issued and outstanding, respectively	3,000	3,000
Series B 10% Convertible Preferred stock, cumulative, \$.001 par value; \$2, and \$2,687 per share liquidation preference; 2,000 shares authorized, 645 shares issued and outstanding	1	1
Common Stock, \$.001 par value; 30,000,000 shares authorized; 16,467,146 and 15,967,146 shares issued; 16,366,618 and 15,866,618 shares outstanding	16,467	15,967
Additional paid-in capital	14,487,305	14,297,920
Accumulated deficit	(14,715,040)	(13,801,991)
Accumulated other comprehensive income	4,790	4,790
Treasury stock, at cost, 100,528 and 100,000 shares	(10,063)	(10,063)
Total shareholders' equity (deficit)	(213,540)	509,624
	\$ 4,089,454	\$ 4,248,887

See Accompanying Notes and Accountant's Compilation Report.

Electronic Control Security Inc.  
Consolidated Statements of Operations

	Year Ended June 30,	
	2015 (Unaudited)	2014 (Audited)
Revenues	\$ 580,550	\$ 656,135
Cost of revenues	<u>576,051</u>	<u>769,617</u>
Gross profit (loss)	<u>4,499</u>	<u>(113,482)</u>
Research and development	-	33,605
Selling, general and administrative expenses	714,150	807,914
Stock based compensation	<u>-</u>	<u>15,043</u>
Loss from operations	(709,651)	(970,044)
Other expenses		
Interest expense	119,827	115,945
Other, net	<u>4,964</u>	<u>5,416</u>
Total other expenses	<u>124,791</u>	<u>121,361</u>
Loss before income taxes	(834,442)	(1,091,405)
Income tax benefits	<u>(101,279)</u>	<u>(163,903)</u>
Loss before dividends	(733,163)	(927,502)
Dividends related to convertible preferred stock	<u>239,886</u>	<u>222,968</u>
Net loss attributable to common shareholders	<u>\$ (973,049)</u>	<u>\$ (1,150,470)</u>
Net loss per share:		
Basic	<u>\$ (0.06)</u>	<u>\$ (0.07)</u>
Diluted	<u>\$ (0.06)</u>	<u>\$ (0.07)</u>
Weighted average number of common shares and equivalents:		
Basic	<u>16,074,837</u>	<u>15,866,622</u>
Diluted	<u>16,074,837</u>	<u>15,866,622</u>

See Accompanying Notes and Accountant's Compilation Report.

Electronic Control Security Inc.  
Consolidated Statements of Comprehensive Income (Loss)

	Year Ended June 30,	
	2015 (Unaudited)	2014 (Audited)
Loss before dividends	\$ (733,163)	\$ (927,502)
Other comprehensive income, net of tax:		
Foreign currency translation adjustments	<u>          -</u>	<u>          -</u>
Comprehensive loss	<u>\$ (733,163)</u>	<u>\$ (927,502)</u>

See Accompanying Notes and Accountant's Compilation Report.



Electronic Control Security Inc.  
Consolidated Statements of Cash Flows

	Year Ended June 30,	
	2015	2014
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>		
<b>Cash flows from operating activities:</b>		
Loss before dividends related to preferred stock	\$ (733,163)	\$ (927,502)
Adjustments to reconcile loss to net cash used in operating activities:		
Depreciation and amortization	162,651	163,631
Deferred income taxes	(110,495)	(164,274)
Increase in allowance for doubtful accounts	15,000	15,238
Increase in reserve for inventory obsolescence	14,000	81,000
Stock based compensation	-	15,043
Increase (decrease) in cash attributable to changes in		
Accounts receivable	(37,448)	(124,449)
Inventories	118,063	125,175
Other current assets	15,478	(753)
Accounts payable and accrued expenses	190,499	315,189
Other assets and liabilities	<u>(1,409)</u>	<u>(6,649)</u>
Net cash used in operating activities	(366,824)	(508,351)
<b>Cash flows from investing activities:</b>		
Acquisition of property plant and equipment	<u>(11,540)</u>	<u>-</u>
Net cash used in investing activities	(11,540)	-
<b>Cash flows from financing activities:</b>		
Payments on long-term debt and lease	(38,199)	(33,587)
Purchase of treasury stock	-	(63)
Issuance of common stock	10,000	-
Increase in due to officers, shareholders and affiliates	<u>411,431</u>	<u>541,445</u>
Net cash provided by financing activities	<u>383,232</u>	<u>507,795</u>
Net decrease in cash and cash equivalents	4,868	(556)
Cash and cash equivalents at beginning of period	<u>-</u>	<u>556</u>
Cash and cash equivalents at end of period	<u>\$ 4,868</u>	<u>\$ -</u>
<b>Supplemental disclosures of cash flow information</b>		
<b>Cash paid during the period for:</b>		
Interest	<u>\$ 38,271</u>	<u>\$ 33,617</u>
Taxes	<u>\$ -</u>	<u>\$ -</u>
<b>Supplemental disclosures of noncash investing and financing activities:</b>		
Acquisition of equipment utilizing a long-term capital lease	<u>\$ -</u>	<u>\$ 11,000</u>

See Accompanying Notes and Accountant's Compilation Report.

Electronic Control Security Inc.  
Consolidated Statements of Changes in Shareholders' Equity (Deficit)

	Series A Convertible Preferred Stock Shares	Series A Convertible Preferred Stock Amount	Series B 10% Convertible Preferred Stock Shares	Series B 10% Convertible Preferred Stock Amount	Common Stock Shares	Common Stock Amount	Additional Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Treasury Stock	Total
Balances at July 1, 2013	300,000	\$ 3,000	645	\$ 1	15,967,146	\$ 15,967	\$ 14,119,909	\$ (12,711,521)	\$ 4,790	\$ (10,000)	\$ 1,422,146
Purchase of treasury stock										(63)	(63)
Dividend on Series B preferred stock							162,968	(162,968)			-
Stock based compensation							15,042				15,042
Net loss								(927,502)			(927,502)
Balances at June 30, 2014	300,000	3,000	645	1	15,967,146	15,967	14,297,919	(13,801,991)	4,790	(10,063)	509,623
Issuance of stock					500,000	500	9,500				10,000
Dividend on Series B preferred stock							179,886	(179,886)			-
Net loss								(733,163)			(733,163)
Balances at June 30, 2015	300,000	\$ 3,000	645	\$ 1	16,467,146	\$ 16,467	\$ 14,487,305	\$ (14,715,040)	\$ 4,790	\$ (10,063)	\$ (213,540)

See Accompanying Notes and Accountant's Compilation Report.

# **Electronic Control Security Inc.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

### **Note 1 – Nature of Operations**

Electronic Control Security, Inc. (the “Company”) is engaged in the design, development, manufacture and marketing of technology-based integrated security solutions. The Company also performs support services consisting of risk assessment and vulnerability studies to ascertain a customer's security requirements in developing a comprehensive risk management and mitigation program as well as product design and engineering services in support of the systems integrators and dealers/installers providing these services to a client.

The Company's office and manufacturing facilities are located in Clifton, New Jersey. Products and services are marketed domestically and internationally to national and local government entities, chemical and petrochemical facilities, energy facilities, commercial transportation centers, border security, and water and agricultural resources.

### **Note 2 - Summary of Significant Accounting Policies**

#### **Basis of Presentation**

The consolidated financial statements have been prepared assuming the Company will continue as a going concern, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company incurred losses before dividends of \$733,163 and \$927,502 in the years ended June 30, 2015 and 2014, respectively. Our cash flow and liquidity have been severely impacted by the refusal by Lockheed Martin to pay us for the accounts receivable due from them totaling nearly \$1 million. Through the years ended June 30, 2015, 2014 and 2013, the principal source of funds used to finance the Company's operations has been advances from officers, shareholders and affiliates and accrued costs due to those parties. There is no assurance that those parties will continue to provide the operating funds. Through Fiscal 2014 and 2015, there were continuing delays in release of funding at the Department of Defense and Department of Energy on projects where we serve as a prime contractor and as a subcontractor. The budget constraints and budget uncertainty at the U.S. government agencies have significantly reduced the issuance of orders and delayed projects for all participants in our industry. These factors raise concern about the Company's ability to continue as a going concern.

The Company has working capital deficit of about \$1.71 million and shareholders' deficit of about \$214,000 as of June 30, 2015. Officers, shareholders and affiliates provided funds in the form of cash advances and deferral of accrued costs and expenses due to them during Fiscal 2015 of \$411,431 and during Fiscal 2014 of \$541,445.

In September 2015, we entered into an agreement with our principal lender, Atlantic Stewardship Bank (“ASB”) to extend the final due date of our term loan with ASB. The term loan has been extended to August 15, 2017, from the prior due date of June 15, 2015. Under the terms of the revised agreement, the monthly payment increases to \$6,000 from the prior \$5,000. All other terms of the agreement remain unchanged. As a result of the revised agreement, approximately \$341,000 of the loan balance and the \$848,080 of subordinated liabilities to officers and shareholders will, in the first quarter of Fiscal 2016, be reclassified from current liabilities to non-current liabilities, thereby improving the Company's working capital position by approximately \$1,189,000. If the Company should require financing of its future accounts receivable, the Company has access to a secured accounts receivable line of credit with Amerisource of approximately \$5 million.

In Fiscal 2015 and 2014 the Company was awarded, as the prime contractor or as a subcontractor, several contracts from units of the Department of Defense. These contracts awarded provide that task orders under the contracts will require competitive bids to be submitted by the Company as those task orders are issued. Through

# **Electronic Control Security Inc.**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Fiscal 2013, 2014, and 2015, the Company has sought to expand its business both domestically and internationally by continuing to submit proposals in response to Request for Proposals (“RFP’s”).

The Company’s ability to continue its operations is dependent upon our ability to generate sufficient cash flow either from operations, from continued funds from officers and shareholders or from additional financing. The accompanying consolidated financial statements do not include any adjustments that might result from the outcome of these uncertainties.

### **Principles of Consolidation**

The financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated.

### **Accounts Receivable**

Trade accounts receivable are recorded net of an allowance for expected losses. The allowance is estimated from historical performance and projections of trends.

### **Inventories**

Inventories are stated at the lower of cost (first-in, first-out) or market. A reserve for potentially obsolete or slow-moving inventory is provided based on management’s analysis of inventory aging, inventory levels and future sales forecasts. The Company has provided a reserve for obsolescence of \$175,000 and \$161,000 of finished goods inventory at June 30, 2015 and 2014, respectively.

### **Property and Equipment and Depreciation**

Depreciation is provided for by the straight-line method over the estimated useful lives of the assets, which vary from three to ten years. Cost of repairs and maintenance are charged to operations in the period incurred.

### **Software Development Costs**

Software development costs are expensed as incurred until technological feasibility is established. Software development costs incurred subsequent to establishing technological feasibility are capitalized and amortized. Amortization is provided based on the greater of the ratios that current gross revenues for a product bear to the total of current and anticipated future gross revenues for that product, or the straight-line method over the estimated useful life of the product. The estimated useful life for the straight-line method is determined to be five years. There were no software development costs capitalized in the year ended June 30, 2015.

### **Earnings per Share**

Basic earnings per share is computed based on the weighted-average number of shares of the Company's common stock outstanding. Diluted earnings per share are computed based on the weighted-average number of shares of the Company's common stock, including common stock equivalents outstanding.

Certain common shares consisting of stock options and convertible preferred stock that would have an anti-dilutive effect were not included in the diluted earnings per share attributable to common stockholders for the years ended June 30, 2015 and 2014.

**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following is a reconciliation of the denominators of the basic and diluted earnings per share computations:

	<u>Year Ended June 30,</u>	
	<u>2015</u>	<u>2014</u>
Denominators:		
Weighted-average shares outstanding used to compute basic earnings per share	16,074,837	15,866,862
Effect of dilutive stock options	-----	-----
	--	--
Weighted-average shares outstanding and dilutive securities used to compute dilutive earnings per share	<u>16,074,837</u>	<u>15,866,862</u>

For the year ended June 30, 2015, there were outstanding potential common equivalent shares of 4,029,233 compared to 4,146,297 for the year ended June 30, 2014, which were excluded from the computation of diluted earnings per share because the effect would have been anti-dilutive. These potential dilutive common equivalent shares may be dilutive to future diluted earnings per share.

**Foreign Currency Translation**

The functional currency of the Company's foreign subsidiaries is the local currency. Accordingly, the Company translates all assets and liabilities into U.S. dollars at current rates. Revenues, costs, and expenses are translated at average rates during each reporting period. Gains and losses resulting from the translation of the consolidated financial statements are excluded from results of operations and are reflected as a translation adjustment and a separate component of stockholders' equity.

Gains and losses resulting from foreign currency transactions are recognized in the consolidated statement of operations in the period they occur.

**Cash and Cash Equivalents**

The Company considers all deposits with an original maturity of three months or less to be cash equivalents.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**Long-lived assets**

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that the assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.

**Revenue Recognition**

The Company recognizes product revenue at the time of shipment. Revenues from consulting and design services are recognized at the time the services are rendered. Revenue under contracts with periods of performance of greater than one year is recognized utilizing the percentage of completion method. The Company had no contracts at June 30, 2015, with durations of more than one year.

## **Electronic Control Security Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The Company also provides professional and technical services under specific contracts, based on a time and material plus fixed profit basis. Revenue on these contracts are recognized to the extent of costs incurred plus a proportionate amount of profit earned. Contract costs including indirect costs are subject to audit by agencies of the United States Government. Management believes future adjustments, if any, from government cost audits will not have a material effect on the financial statements.

#### **Warranty Reserve**

All of the Company's products carry a warranty and the Company maintains a reserve for warranty work based on historical experience and anticipation of possible warranty work. IPID® sensors are warranted for ten years, under normal use, against defects in workmanship and material from date of installation of the system on the customer's premises. All other components are warranted to the extent of the warranty given by the actual manufacturer. FOIDS® processors are warranted for a ten year period. For the years ended June 30, 2015 and 2014, net expenses attributable to warranties were well below the amounts accrued.

#### **Research and Development**

Research and development expenditures are expensed as incurred. Research and development costs for the year ended June 30, 2014 amounted to \$33,605 (none in the year ended June 30, 2015).

#### **Income Taxes**

The Company accounts for income taxes in accordance with accounting guidance now codified as Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 740, "Income Taxes," which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax bases of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when it is more likely than not that some or all deferred tax assets will not be realized.

Effective July 1, 2007, the Company adopted the provisions of FASB ASC 740-10-05, "Accounting for Uncertainties in Income Taxes." The ASC clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements. The ASC prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The ASC provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

#### **Intangible Assets**

The cost of licenses, patents, and trademarks are being amortized on the straight-line method over their useful lives, ranging from five to 20 years.

#### **Advertising Costs**

Advertising costs are reported in selling, general and administrative expenses, and include advertising, marketing and promotional programs. These costs are charged to expense in the year in which they are incurred. The Company, and did not incur advertising costs for the years ended June 30, 2015 and 2014.

#### **Shipping and Handling**

Shipping and handling costs are recorded as costs of revenues and are approximately \$5,484 and \$3,038 for the years ended June 30, 2015 and 2014, respectively.

# Electronic Control Security Inc.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Stock Based Compensation

The Company accounts for stock-based compensation in accordance with accounting guidance now codified as FASB ASC Topic 718, "Compensation – Stock Compensation." Under the fair value recognition provision of FASB ASC Topic 718, stock-based compensation cost is estimated at the grant date based on the fair value of the award. The Company estimates the fair value of stock options granted using the Black-Scholes-Merton option pricing model.

### Fair Value of Financial Instruments

Substantially all of the Company's financial instruments, consisting primarily of cash and cash equivalents, accounts receivable, accounts payable and accrued expenses, and other current liabilities, are carried at, or approximate, fair value because of their short-term nature or because they carry market rates of interest.

### Recent Pronouncements

In May 2014, the FASB ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides a five-step process to achieve that core principle. ASU 2014-09 requires disclosures enabling users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, using one of two retrospective application methods. Early application is not permitted. The company is currently evaluating the effect that the adoption of this ASU will have on its financial statements. In August 2015, the FASB ASU No. 2015-14 deferred the effective date of the above ASU No. 2015-09 by one year.

In August 2014, the FASB NO. 2014-15, Presentation of Financial Statement-Going Concern, provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and its responsibility to provide related footnote disclosures. ASU No. 2014-05 is effective for the Company's fiscal year beginning July 1, 2016. Management has not yet determined the effect on its financial statements in Fiscal 2017.

Management does not believe that any other recently issued, but not yet effective, accounting standard if currently adopted would have a material effect on the accompanying financial statements.

### Note 3 - Inventories

Inventories at June 30, 2015 and 2014 consisted of the following:

	<u>2015</u>	<u>2014</u>
Raw materials	\$ 250,870	\$ 253,611
Work-in-process	265,528	284,307
Finished goods	<u>1,162,567</u>	<u>1,262,110</u>
Subtotal	1,678,965	1,797,028
Allowance	<u>(175,000)</u>	<u>(161,000)</u>
	\$ <u>1,503,965</u>	\$ <u>1,636,028</u>

**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 4 – Property, Equipment and Software Development Costs**

Property, equipment and software development costs at June 30, 2015 and 2014 consisted of the following:

	<u>2015</u>	<u>2014</u>
Furniture and fixtures	\$ 65,032	\$ 65,032
Machinery and equipment	1,075,722	1,064,183
Improvements	23,008	23,008
Software	125,914	125,914
Software development costs	<u>163,896</u>	<u>163,896</u>
	1,453,572	1,442,033
Less: accumulated depreciation and amortization	<u>1,376,063</u>	<u>1,294,111</u>
	\$ <u>77,509</u>	\$ <u>147,922</u>

Depreciation and amortization expense was \$81,952 and \$82,479 for the years ended June 30, 2015 and 2014, respectively.

**Note 5 – Intangibles**

	June 30, 2015		June 30, 2014	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Licenses	\$ 50,000	\$ 50,000	\$ 50,000	\$ 50,000
Patent	852,793	484,342	852,793	437,470
Trademarks	577,263	298,252	577,263	269,389
Other	8,881	8,881	8,881	8,881
	<u>\$ 1,488,937</u>	<u>\$ 841,475</u>	<u>\$ 1,488,937</u>	<u>\$ 765,740</u>

Amortization expense charged to operations was \$75,735 for each of the years ended June 30, 2015 and 2014. Future annual amortization expense for the licenses and other intangible assets is expected to be approximately \$75,700 each year for the patents and trademarks through 2022, their estimated remaining useful lives.

**Note 6 – Short-Term and Long-term Debt**

In June 2013, ECSI International, Inc., (the “Subsidiary”), one of the wholly-owned subsidiaries of the Company, and ASB amended the terms of the credit line established in March 2011, such that, effective May 15, 2013, the agreement became a term loan. In September 20115, the Subsidiary and ASB extended the term loan to August 15, 2017. Under the terms of the extension, the principal amount, \$405,329 at June 30, 2014 (\$399, 350 at August 15, 2015), is to be paid in monthly installments of \$6,000, including interest, beginning September 15, 2015 and continuing through July 15, 2017. The remaining balance of approximately \$302,000 is due to be paid on August 15, 2017. The variable interest rate is the prime rate plus 1%, with a minimum interest rate of 5.875%. All other terms of the prior term loan agreement were unchanged.

The above term loan is collateralized by Subsidiary’s accounts receivable, inventories, equipment and general intangibles. As part of the Amendment, the Company’s President and Chief Executive Officer provided a personal guaranty of the amounts due to the Bank, up to a maximum of \$250,000. Three of the Company’s



**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

officers executed subordination agreements which subordinated a combined total of \$848,080 of amounts due to those officers to amounts due by the Subsidiary to the Bank.

**Note 7 - Lease Agreements**

Future minimum annual rental payments required under non-cancelable operating and capitalized leases for years after June 30, 2015 are as follows:

		<u>OPERATING</u>		<u>CAPITALIZED</u>		<u>TOTAL</u>
	2016	\$ 77,137	\$	4,225	\$	81,361
	2017	78,679		2,925		81,604
	2018	<u>66,655</u>		--		<u>66,655</u>
Total obligations		\$ <u>222,471</u>	\$	7,150	\$	<u>229,621</u>
Less amount representing interest				<u>290</u>		
Present value of capitalized lease obligations			\$	6,860		
Less current maturity				<u>3,990</u>		
Long-term lease liability			\$	<u>2,870</u>		

Rent expense under all operating leases was \$106,387 and \$99,584 for the years ended June 30, 2015 and 2014, respectively.

Capitalized lease property included in the Consolidated Balance Sheets is presented below:

		<u>2015</u>		<u>2014</u>
Furniture and fixtures	\$	11,000	\$	11,000
Less accumulated amortization		<u>5,500</u>		<u>1,100</u>
Total obligations	\$	<u>5,500</u>	\$	<u>9,900</u>

**Note 8 – Due to Officers, Shareholders and Affiliates and Subordinated Liabilities to Officers and Shareholders**

These amounts are composed of the following at June 30, 2015 and 2014:

		<u>2015</u>		<u>2014</u>
Interest bearing advances, due on demand	\$	387,177	\$	344,338
Accrued compensation and other costs		<u>1,007,470</u>		<u>638,878</u>
Current liabilities to officers, shareholders and affiliates		1,394,647		983,216
Subordinated liabilities to officers and shareholders		<u>848,080</u>		<u>848,080</u>
	\$	<u>2,242,727</u>	\$	<u>1,831,296</u>

Related to the loan agreement with the ASB discussed in Note 6 above, three of the Company's officers agreed to subordinate a total of \$848,080 of amounts due to those officers to amounts due by the Subsidiary to the Bank.

**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**Note 9 - Income Taxes**

The income tax benefits for the years ended June 30, 2015 and 2014 includes the following components:

	<u>2015</u>	<u>2014</u>
Current		
Federal	\$ -	\$ -
State	<u>9,216</u>	<u>371</u>
Foreign	-	-
	<u>9,216</u>	<u>371</u>
Deferred		
Federal	(65,121)	(176,170)
State	(45,380)	11,896
Foreign	<u>-</u>	<u>-</u>
	<u>(110,501)</u>	<u>(164,274)</u>
	\$ <u>(101,285)</u>	\$ <u>(163,905)</u>

The components of the deferred tax accounts as of June 30, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Deferred tax assets		
Net operating loss carry forwards	\$ 2,848,018	\$ 2,747,931
Allowance for doubtful accounts	180,129	174,138
Accrued compensation and other costs	706,478	558,430
Stock based compensation	214,695	214,695
Other	<u>87,868</u>	<u>82,277</u>
	4,037,188	3,777,471
Deferred tax liabilities		
Depreciation and amortization	<u>73,152</u>	<u>77,049</u>
Subtotal	3,964,036	3,700,422
Valuation allowance	<u>(2,842,787)</u>	<u>(2,689,668)</u>
Net deferred tax assets	\$ <u>1,121,249</u>	\$ <u>1,010,754</u>

The valuation allowance at June 30, 2013 was \$2,416,226.

**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The reconciliation of estimated income taxes attributed to operations at the statutory tax rates to the reported income tax benefit is as follows:

	<u>2015</u>	<u>2014</u>
Expected federal tax at statutory rate	\$ (344,871)	\$ (426,486)
State taxes, net of federal tax effect	(58,019)	(75,223)
Non deductible expenses	74,183	67,392
Change in valuation allowance	134,178	272,503
Other	<u>93,244</u>	<u>(2,090)</u>
	\$ <u>(101,285)</u>	\$ <u>(163,905)</u>

At June 30, 2015, the Company had net operating loss carryforwards for federal and state income tax purposes of \$7,056,875 and \$3,128,417 respectively, expiring through 2035. The Company has foreign net operating loss carryforwards of \$657,134 with no expiration date.

At June 30, 2015 and 2014, the Company had no material unrecognized tax benefits and no adjustments to liabilities or operations were required. The Company does not expect that its unrecognized tax benefits will materially increase within the next twelve months. The Company did not recognize any interest or penalties related to uncertain tax positions at June 30, 2015 and 2014.

The Company files U.S. and state income tax returns in jurisdictions with varying statutes of limitations. The 2008 through 2014 tax years generally remain subject to examination by federal and most state tax authorities.

**Note 10 - Shareholders' Equity (Deficit)**

**Series A Convertible Preferred Stock**

In January to March 2002, the Company realized gross proceeds of \$2,000,000 from the private placement of 40 Units, each Unit consisting of 25,000 shares of Series A Convertible Preferred Stock ("Series A Preferred") and 12,500 common stock purchase Warrants. The Series A Preferred provides for an annual dividend of \$.20 per share, payable quarterly, (payable in cash or shares of common stock valued at \$2.00 per share), when, as and if declared by the Board of Directors. Dividends will be paid on a cumulative basis. Each Series A Preferred share was initially convertible at the option of the holder into one common share, commencing 120 days after closing. The conversion ratio is subject to certain adjustments, as defined and has since been adjusted to \$0.88 Series A Preferred shares for one common share. The Series A Preferred shares have a liquidation preference in the amount of \$2.00 per share and the Company may redeem them if the common shares have traded at or above \$4.00 for a period of twenty consecutive trading days. All of the Warrants issued in connection with this offering have since expired unexercised.

As of June 30, 2015, 700,000 shares of Series A Preferred had been converted into a like amount of common stock.

Cumulative but undeclared dividends at June 30, 2015 total approximately \$795,000.

**Series B Convertible Preferred Stock**

On June 30, 2004, the Company completed a private placement of 2,000 shares of its 10% Series B Convertible Preferred Stock ("Series B Preferred") and warrants to purchase up to 2,000,000 shares of common stock for an aggregate purchase price of \$2,000,000. The Preferred Stock provides for a dividend at the rate of 10% per annum, payable quarterly, (payable in cash or by adding the dollar amount of such dividends to the Stated Value), dividends will be paid on a cumulative basis. The preferred shares have a liquidation preference in the amount of \$1,000 per share and have preference to any payments to the Preferred A shareholders. Each

## **Electronic Control Security Inc.**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

preferred share is convertible at the option of the holder into 1,000 shares of common stock. The conversion price is subject to anti-dilution adjustments, including, among other things, in the event that the Company sells common stock during the next three years for a price of less than one dollar per share. The Company may require the conversion of all (but not less than all) of the then outstanding shares of Series B Preferred Stock, if at any time the volume weighted average trading price per share of common stock for each of 20 consecutive trading days prior to a conversion notice is greater than \$2.50 (subject to adjustment), and the daily trading volume of the common stock is at least 100,000 shares. In addition all shares of common stock underlying the Series B Preferred Stock must be covered by an effective registration statement. All of the Warrants issued in connection with this offering have since expired unexercised. In 2006 the conversion and exercise prices of the Series B Preferred were reduced to \$.75.

#### **Stock Option Plans**

##### **Incentive Stock Option Plan**

In 1986, the Company adopted an Incentive Stock Option Plan, which was renewed in 1996 for a second ten-year term. The Company initially had reserved 1,000,000 shares of common stock for issuance under the Incentive Stock Option Plan, which was increased to 2,000,000 shares upon the approval of the stockholders at the 2005 annual meeting. The board of directors administers the Incentive Stock Option Plan but may delegate such administration to a committee of three persons, one of whom must be a member of the board. The board or the committee has the authority to determine the number of stock options to be granted, when the stock options may be exercised and the exercise price of the stock options, provided that the exercise price may never be less than the fair market value of the shares of the common stock on the date the stock option is granted (110% in the case of any employee who owns more than 10% of the combined voting power or value of all classes of stock). Stock options may be granted for terms not exceeding ten years from the date of the grant, except for stock options granted to any person holding in excess of 5% of our common stock, in which case the stock options may not be granted for a term not to exceed five years from the date of the grant. The Incentive Stock Option Plan expired in September 2006.

##### **Equity Incentive Plan**

In October 2006, the Board adopted the Equity Incentive Plan, which was approved by the shareholders at the annual meeting of shareholders held in December 2006. The Equity Incentive Plan is intended to succeed the Incentive plan, which expired in September 2006. 2,000,000 shares were reserved for issuance under the Equity Incentive Plan. In December 2010, the Shareholders voted to increase the number of shares issuable thereunder to 4,000,000. The Equity Incentive Plan is administered by the Board of Directors or, at the discretion of the Board, by a committee consisting of at least two directors. The administering body, whether it be the Board of Directors or a committee of the type described above, is sometimes referred to as the "Committee." The Committee is authorized from time to time to select and to grant awards under the Equity Incentive Plan to such key employees, non-employee directors, and consultants of the Company and its subsidiaries as the Compensation Committee, in its discretion, selects. The Compensation Committee is authorized to delegate any of its authority under the Equity Incentive Plan (including the authority to grant awards) to such executive officers of the Company as it thinks appropriate and is permitted by Rule 16B-3 of the Exchange Act and Section 162(m) of the Code. The Equity Incentive Plan allows for the grant of a number of different types of awards, including incentive and non-statutory stock options, stock appreciation rights, restricted stock grants, performance units, cash payments and other stock-based awards.

##### **Non-Statutory Stock Option Plan.**

The Company also adopted a Non-Statutory Stock Option Plan and have reserved 250,000 shares of common stock for issuance to directors, employees and non-employees. Stock options granted pursuant to this plan will be non-transferable and expire, if not exercised within five years from the date of the grant. Stock options will be granted in such amounts and at such exercise prices as our board of directors may determine.

Option activity for 2015 and 2014 is summarized as follows:

**Electronic Control Security Inc.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

	<u>Options</u>	<u>Weighted Average Exercise Price</u>
Options outstanding, June 30, 2013	1,475,000	\$ .55
Granted	350,000	.04
Forfeited	(330,000)	.50
Exercised	<u>    --</u>	<u>    --</u>
Options outstanding, June 30, 2014	1,495,000	\$ .44
Granted	--	--
Forfeited	(235,000)	1.16
Exercised	<u>    --</u>	<u>    --</u>
Options outstanding June 30, 2015	<u>1,260,000</u>	<u>\$ .31</u>
Aggregate intrinsic value	<u>\$    --</u>	
Exercisable at June 30, 2015	<u>1,260,000</u>	<u>\$ .31</u>
Shares of common stock available for future grant under the plans	<u>2,245,500</u>	

The aggregate intrinsic value on this table was calculated based on the positive difference between the closing market price of the Company's common stock and the exercise price of the underlying options. No options were exercised in fiscal 2015 and fiscal 2014.

The following table summarizes information about stock options outstanding at June 30, 2015:

<u>Ranges of price</u>	<u>Number Outstanding</u>	<u>Weighted Average Remaining</u>		<u>Options Exercisable Weighted</u>	
		<u>Contractual Life</u>	<u>Exercise Price</u>	<u>Number Exercisable</u>	<u>Average Exercise Price</u>
\$.04-.05	350,000	7.83	\$ .04	350,000	\$ .04
\$.07	60,000	3.47	\$ .07	60,000	\$ .07
\$.17	155,000	4.44	\$ .17	155,000	\$ .17
\$.19	140,000	6.36	\$ .19	140,000	\$ .19
\$.21-.22	220,000	2.90	\$ .22	220,000	\$ .22
\$.75	275,000	1.75	\$ .75	275,000	\$ .75
\$1.07	<u>60,000</u>	<u>.44</u>	<u>\$1.07</u>	<u>60,000</u>	<u>\$1.07</u>
\$.07-\$1.07	<u>1,260,000</u>	<u>4.50</u>	<u>\$ .44</u>	<u>1,260,000</u>	<u>\$ .44</u>

The fair value of each option grant is estimate on the date of grant using the Black-Scholes option-pricing model. The Company uses historical data to estimate expected volatility, the period of time that option grants are expected to be outstanding, as well as employee termination behavior. The risk-free rate is based on the U.S. Treasury yield in effect at the time of grant for the estimated life of the option. The following weighted-average assumptions were used to estimate the fair value of options granted during the fiscal year ended June

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

30, 2014, using the Black-Scholes option-pricing (no options were granted during the fiscal year ended June 30, 2015):

	2014
Risk free interest rate	2.63%
Expected life	10
Expected volatility	158.3%
Dividend yield	0%
Weighted-average grant date fair value per share	\$0.04

As of June 30, 2015, there was no unrecognized compensation cost related to non-vested options granted because all options have vested.

### Note 11 - Concentrations and Economic Dependency

The Company had two customers that accounted for 40% and 12% of net revenues for the year ended June 30, 2015 and three customers that accounted for 42%, 14%, and 6% of net revenues for the year ended June 30, 2014. Two customers accounted for approximately 80% and 11% of the accounts receivable as of June 30, 2015. At June 30, 2015 approximately 2% of accounts receivable were from foreign customers. The Company performs ongoing credit evaluations of its customers' financial condition and generally requires no collateral from its customers.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash in financial institutions. At June 30, 2015 and 2014, substantially all of the Company's cash was in two banks. The amount that is federally insured is subject to FDIC's limit of \$250,000 per depositor per insured bank. The Company did not have balances that exceeded FDIC limits at June 30, 2015 and 2014.

### Note 12 – Commitments and Contingencies

#### Legal Proceeding

On March 7, 2012, the Company, through its wholly-owned subsidiary, ECSI International, Inc. filed a lawsuit in the United States District Court for the District of New Jersey against Lockheed Martin Global Training and Logistics ("Lockheed Martin"). The lawsuit, as detailed in the First Amended Complaint and Demand for Trial by Jury (the "Amended Complaint") dated March 29, 2012, alleges breach of contract and tortious interference by Lockheed Martin and seeks actual damages of approximately \$978,000, as well as punitive damages, costs and such further relief as the Court deems equitable and proper. In addition, the Amended Complaint seeks payment under Lockheed Martin's payment bonds required by the United States Navy Facilities Engineering Command. At June 30, 2015 and 2014, the Company has included in its accounts receivable (prior to allowances) the amount of the actual damages claimed. In Fiscal 2013, Lockheed Martin was granted a motion to have the matter moved from New Jersey to Maryland. We had been aggressively pursuing our claim against Lockheed Martin. However, due to cash flow constraints, we have not yet pursued our claims against Lockheed Martin in Maryland.

#### Loss Contingencies

Loss contingencies, including claims and legal actions arising in the ordinary course of business, are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated. Management does not believe there now are such matters that will have a material effect on the financial statements.

### Note 13 – Geographic Data

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The Company currently operates in the United States and the Middle East. The following is a summary of local operations by geographic area:

	<u>U.S.</u>	<u>% of total</u>	<u>Other</u>	<u>% of total</u>
For the year ended				
June 30, 2015				
Revenue	\$ 561,615	96.78 %	\$ 18,935	3.22%
Operating income (loss)	(671,009)	94.55 %	(38,642)	5.45%
Identifiable assets	4,032,698	98.51 %	60,941	1.49%
For the year ended				
June 30, 2014				
Revenue	\$ 646,415	98.52%	\$ 9,720	1.48%
Operating income (loss)	(969,395)	(100.39)%	3,823	.39%
Identifiable assets	4,174,083	97.99%	85,685	2.01%

**Note 14 -- Related Party Transactions**

Refer to Note 8 above for information regarding amounts due to officers and directors of the Company.

In January 2015, a director of the Company agreed to purchase 500,000 restricted shares of the Company's common stock at a price of \$.02/share, the price quoted in the OTC Pink Sheets on the date of purchase. The Company agreed that the director may sell any or all of the shares to the Company at any time after January 29, 2016, at a price of \$.04/share, at the director's option.

**Note 15 -- Subsequent Events**

For the year ended June 30, 2015, the Company has evaluated subsequent events for potential recognition and disclosure through September 28, 2015, the date of the financial statement issuance. Refer to Note 6 above for information related to the extension of the Company's term loan.